VZCZCXRO9529
OO RUEHROV
DE RUEHDS #1943/01 1990813
ZNR UUUUU ZZH
O 170813Z JUL 08
FM AMEMBASSY ADDIS ABABA
TO RUEHC/SECSTATE WASHDC IMMEDIATE 1326
INFO RUCNIAD/IGAD COLLECTIVE
RUEATRS/DEPT OF TREASURY WASHINGTON DC
RUEHLMC/MILLENNIUM CHALLENGE CORP
RUEAIIA/CIA WASHINGTON DC
RHMFISS/CJTF HOA
RUEWMFD/HQ USAFRICOM STUTTGART GE
RHMFIUU/HQ USCENTCOM MACDILL AFB FL
RUEKJCS/JOINT STAFF WASHINGTON DC
RHEHAAA/NSC WASHDC
RUEKJCS/SECDEF WASHINGTON DC
RUEKDIA/DIA WASHINGTON DC
RUEHFSC/USOFFICE FSC CHARLESTON 9737

UNCLAS SECTION 01 OF 02 ADDIS ABABA 001943

SIPDIS

STATE FOR AF/EX, OP/OE, ALLOWANCES OFFICE

E.O. 12958: N/A
TAGS: ALOW ECON PGOV ET
SUBJECT: INFLATION PEAKS, THE PUBLIC FEELS THE PINCH

ADDIS ABAB 00001943 001.2 OF 002

¶1. In June, Ethiopia's general inflation rate hit 55.3 percent on an annualized basis (from June 2007 to June 2008). Food inflation ticked in at 78.2 percent and cereal inflation, as a subset of food inflation, soared 132.5 percent over the same period. Cereals include staple grains such as teff, wheat, barley, sorghum and corn. Factors contributing to the sharp increase in prices include the failure of the Belg rains in many regions earlier this year, effectively destroying the short rains harvests that comprise 15 to 20 percent of Ethiopia's annual agricultural output, sharp increases in fuel prices, market inefficiencies, uncurbed government spending, and expansionary monetary policy.

¶2. The sharp rise in inflation is unprecedented since the reign of the communist Derg regime. For the past seventeen years, Ethiopia has had one of the lowest inflation rates among sub-Saharan African countries. In general, inflation has been confined to single-digits during that time. However, as a predominantly agrarian economy, Ethiopia has had periodic spikes in inflation due to the failure of rain-fed harvests as cyclical droughts have from time to time depressed agricultural output. Conversely, recent bumper harvests have reduced inflation. Prior to February, 2008, Ethiopia's highest inflation rate was 21 percent, recorded in 1990/1991 during the aberration of the instability caused by the transfer of power from the Derg regime to the current ruling Ethiopian People's Revolutionary Democratic Front (EPRDF). However, over the past three years inflation has risen steadily despite good rains (until this year) and double digit economic growth, finally surpassing the previous historical high with a rate of 22.9 percent in February of this year.

¶3. The stability implications of current inflationary pressures are unclear at present. A local journalist told us that Ethiopians are used to lean times and adjust there lifestyles accordingly. However, other anecdotal evidence suggests that both urban and rural residents are feeling the pinch. The Embassy has received a report of unprecedented looting of food stocks, led by students and civil servants, in Western Oromiya, near Jima. In Addis Ababa, the Embassy has noticed an up-tick of thefts targeting expatriates and middle-class Ethiopians in recent months, including an unsuccessful (non-AmCit) home invasion last week. One

foreign service national noted that in his Addis Ababa neighborhood, elderly women ordinarily confined to the home have been spotted begging in the evenings in neighboring locales to obtain food to feed their families. To mitigate the adverse impact of the broader drought-related food crisis on ordinary Ethiopians, the United States, as Ethiopia's leading donor, will provide USD 460 million in food assistance (500,000 metric tons), constituting more than 80 percent of food donations to Ethiopia this year.

¶4. Comment: While heavy rains in certain areas of the country over the past month may eventually ease price pressures for staple grains, the next harvest will not come until December. As a result, inflation for food and cereals is expected to continue to rise through year's end. The pending 25 percent increase in port fees from Djibouti in mid-August will only fuel inflation. The Ethiopian government has responded by importing 1.5 million quintals of wheat in an effort to stabilize prices. Delivery is expected in August. However, Ethiopia's inflationary pressures are generally not tied to rises in world commodity prices, as key Ethiopian grains, such as teff, are not generally traded in world markets. Rather, the inflationary pressures reflect inefficiencies in Ethiopia's internal market mechanisms and the failure of rains earlier in the year. Even with a bumper harvest in December, food prices may not decline significantly in real terms given the other pressures in the economy. Economic conditions for ordinary Ethiopians, including our locally engaged staff colleagues, will likely get much worse before any relief. The recently zeroed out Post allowance should now be raised in response to this inflation and Post will look to work with Washington on ways to mitigate the effects of this inflation on local staff salaries. At a minimum, an off-cycle raise based on foreign currency gains over the past



fiscal year (the birr continues to decline against the dollar, approximately seven percent over the past nine months) would help. End Comment.
YAMAMOTO